

IT Outsourcing

Third Time Lucky?

Coeus Consulting looks at whether the emerging third generation sourcing models are the end of the journey or is a fourth generation on the way?

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Third Time Lucky?

With many organisations now entering into '3rd Generation' IT outsourcing contracts, it is worth-while reflecting upon the original intentions and drivers of '1st Generation' contracts to see if history is going to go full circle or whether it will be third time lucky...

Outsourcing of IT has evolved over the years and whilst the original '1st Generation' single service provider outsource deals were mainly targeted at saving money, they were also about pushing the risk of delivery onto the external supplier. Some of key drivers for shifting the risk onto a supplier were around in-house staff; specifically skills shortages and attrition issues.

As technology has evolved, and IT services have become more critical to core business delivery, mature organisations have moved to more agile multi-sourcing models. These '2nd generation' contracts are based on selectively sourcing elements of an organisations IT services. Rather than focusing on replicating an organisations IT services delivered at lower cost, the key outcomes of this type of outsourcing model are to utilise the best fit suppliers for each IT service to enable the transformation of those IT services in order to deliver real and beneficial technology change to support business strategy.

In multi-sourcing, the customer enters into separate, parallel agreements with different suppliers for different parts of the services to be outsourced. A typical multi-sourcing model might involve Supplier A performing data centre functions, Supplier B performing desktop functions and Supplier C performing network functions. Additionally one of these suppliers (or a separate supplier) can also act as "operational integrator" of services performed by other service providers.

Whilst organisations want to retain efficiency, strong governance and value for money in their IT outsourcing deals they now also have expectations for providers to

integrate and cooperate within this flexible, multi-sourced environment. Additionally, to enable greater business alignment, these organisations also want to regain control of their IT strategy and assets, and maintain internal expertise to allow knowledgeable supervision of outsourced specialised tasks like infrastructure management and applications development.

So Why Change?

The '2nd Generation' multi-source operating model has its own challenges due to the need to govern, manage and coordinate activities across multiple internal and external IT service delivery functions. It can lead to gaps and overlaps between the functions, and these can increase, not decrease, timescales and costs of the end to end IT services. Additionally, most of these deals have been set-up as multiple bilateral agreements which sit alongside each other rather than providing an integrated collaborative set of IT services.

Although cost-cutting was the original motivation for choosing outsourcing for the majority of customers now, whilst cost reduction is still expected, customers think 'strategic alignment' and 'business transformation' are the most critical elements of IT service delivery today.

Third generation sourcing seeks to establish the optimal mix of internal and external providers for delivery of IS services, which are determined by assessing each IS service for its impact on the business and the level of collaboration with the business required to deliver the service. Key determining questions include; does the function require a significant knowledge of the business that is not readily achieved, does the activity / function contribute directly to the Business / IT strategy, is this a business facing function, do long-term business relationships contribute to the success of the function.

Third generation sourcing utilises the best sourcing model relevant to each specific IT service, defined as 'right sourcing'. To successfully define the correct sourcing model, the organisation needs to understand the types of out-sourcing arrangements available and the best alignment of these models to strategic IT service delivery.

Sourcing Models

Retained organisations - The internal organisation should be considered as one of the ways in which you source services, after all they are best placed to understand the nuances and complexity of the business.

Staff Augmentation - Providers are used to supplement resource shortfall or gain immediate cost savings.

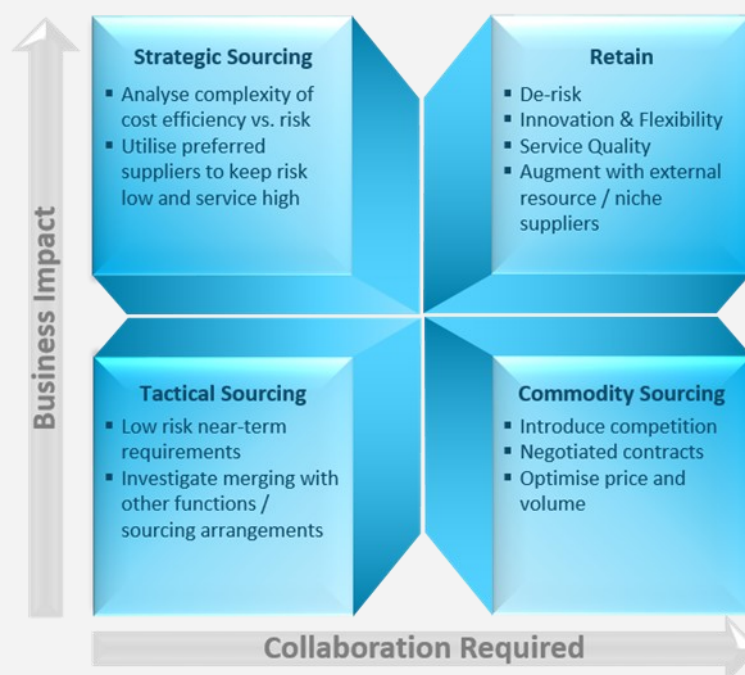
Out Tasking - Provides a skill or capability from provider, specific tasks can be given to provider. Management skill requirement increased and dependency management still in-house.

Project Based Outsourcing - Delivery is outsourced with clear delivery responsibility on provider. Multi-source framework agreements bring additional benefits and competitive tension to improve service and reduce costs. Project risk is owned by outsourced provider(s) however business risk still in-house. Internal vendor management and service integration capabilities are essential.

Managed Services - Complex agreements for provision of managed services with clear outcomes based focus. Most suited for functions that can be outsourced as a single end-to-end service. Significant internal vendor management and service integration capabilities are required to successfully manage these types of partnership.

Strategic Services - IS services are assessed to determine the most appropriate sourcing strategy to use, retaining critical business impacting IT services internally and aligning other IT services to the best outsourcing model. Significant internal service delivery and vendor management capabilities are required to successfully manage cohesive end-to-end IT services.

Determining the right sourcing model





Trends in Third Generation Outsourcing

One of the key shortcomings of first and second generation outsourcing is that there is a large gap between what customers want and expect and what suppliers are delivering, particularly in areas such as; transparency, understanding the business model, innovative solution architectures, data management and service innovation. Mitigations can be put in place to address these shortcomings, such as:

- Retained expertise in the customer organisation is essential, including maintaining an intimate understanding of how the service works as it evolves through the transformational process.
- Make certain that business goals are clear, unambiguous and measurable – because these are the measures upon which the suppliers remuneration will be based, they have to be clearly linked to supplier performance.
- Ensuring that operations to be outsourced are well defined, that current processes are clearly articulated, and internally focused performance measures established.
- Ensuring that the right management disciplines and governance is in place to keep the customer / supplier relationship on track – procurement is only the first step in a long journey. It is important to have strong control mechanisms and a diligent operational focus on all sides, which requires

resource and commitment from the leadership teams of both customers and suppliers.

- Established capability for service integration and management (SIAM) is vital for delivery of complex ‘multi-layered’ outsourcing contracts, yet only a small minority of customers feel extremely confident about managing the process internally. This has established a trend of outsourcing SIAM to either an existing outsource supplier partner or a specialist SIAM supplier, however, it is difficult to outsource a capability with such strong links to business performance and where the SIAM provider does not have contractual control over other 3rd parties delivering IS services. To overcome both of these issues, many organisations are retaining the “service intelligence” elements of SIAM internally (elements requiring specific business knowledge) whilst supplementing SIAM capabilities with proficient external support.

Other trends in outsourcing include the continued erosion of the financial advantages of offshore labour arbitrage, high attrition, political sensitivities and increased scrutiny on regulatory and data privacy issues, will result in a higher share of deals being reshored. Not only are companies bringing back critical services and processes to their captive centres, they are proactively looking at rural domestic sourcing providers (supported by attractive tax incentives) that can leverage low cost locations in the US and UK.

Common Challenges in Third Generation Sourcing

One could be forgiven for thinking that the industry has forgotten some of the original drivers for outsourcing in the first place, when 3rd Generation contracts look to potentially increase the workload on retained organisations. The original challenges around skills and retention will still exist and possibly pose one of the biggest challenges on 3rd Generation contracts.

One of the most basic, but key, steps that a customer can take to manage its risks is to ensure it has the right retention of control over the outsourcing. Irrespective of the attempt to create the best possible contract, an outsourcing arrangement (particularly in multi-sourcing) is likely to fail if the post-signature contract and operational management activities are understaffed or poorly performed by the customer.

Whilst most organisations will have a degree of multi-sourcing, as they typically would have separate application providers to infrastructure, a more granular level of sourcing does require very careful planning. At the heart of successful multi-sourcing organisations is a clear and precise operating model which allows all parties to clearly understand the service boundaries and hand-off points between both the customer and all suppliers and between each supplier.

Accurately documenting dependencies is critical in a multi-sourced environment, to minimise its risks and liabilities as much as possible – defining the services that must be supplied, the set of services allocated to each supplier, and how the different sets of services relate to and depend on each other.

A disadvantage to having multiple suppliers is that suppliers from similar sectors may be wary of entering into contracts that require close co-operation with competitors, for fear of making their confidential information or intellectual property available to a competitor. Customers can attempt to manage this concern by using Operating Level Agreements (OLAs) that address the sharing of confidential information and define a degree of shared responsibility on suppliers for service continuity. OLAs must be set up so that if a problem arises, each party's immediate focus

is on fixing it, leaving arguments over responsibility for, and payment of, remedial costs until later.

Having multiple, potentially niche suppliers, rather than one large outsourcer, the number of moving parts to monitor increases dramatically. That's why customers must define a performance dashboard mechanism that gives a current, holistic and consistent view on what is being delivered across all IT services (whether internally or externally delivered). By linking the performance dashboard to the key business process data of the organisation, the outcomes and effect of any changes can be monitored and opportunities and risks can be managed.

An issue in any outsourcing agreement, particularly in multi-sourcing, is ensuring that all suppliers are equally up to date in terms of processes. In any successful IT outsource, customers spend a lot of time and effort standardising common IT processes, so that suppliers are interchangeable or can effectively work together. The use of standard templates is fundamental to success in multi-sourcing, as a basis for operational delivery and monitoring.

Benefits of Third Generation Outsourcing

Third generation outsourcing aims to combine the benefits of previous outsourcing models, optimising the transformational potential from outsourcing IT services. Key benefits include:

- The customer benefits from flexibility as it is not locked in to one supplier, it's easier to swap out one piece of the solution than the whole solution.
- The customer can tender competitive offers from various suppliers on the basis of service as well as price, not being limited only to large enterprise level suppliers but instead opening the door for smaller specialist suppliers. Smaller specialist organisations often offer greater business value and better flexibility, while bigger organisations are often constrained by a requirement to deliver specific margins and project sizes limiting the scope of services they can provide.

- Individual services can have shorter term contracts, which is proven to be a more motivational and less confrontational way of working with suppliers rather than long-term SLAS and service credits.
- The customer is free to choose the best supplier for each outsourced service, customers expect that hiring a supplier with the greatest skill in a particular area will increase the long-term value of the contract for the customer and benefit the customer in the form of service quality, specialist expertise and innovation.
- A holistically designed right-sourced operating model can be focused on sharing goals, and innovation happens on an incremental basis through sharing ideas across internal and external teams.
- The SIAM organisation can guarantee that the customer deals with each service provider directly, ensuring that they have access to the required specialists and clear points of contact and lines of communication, which can often be unclear when using a single provider providing multiple services.
- Retaining internal IT capability allows the customer to take hands on approach to service transformation, bringing suppliers together to work through issues and ideas, which can facilitate innovative thinking and help improve communication between multiple suppliers working in different areas while ensuring that overall focus was on the key business goals.



Summary

Third generation outsourcing aims to provide the best blend of internal capability and external multi-sourcing to ensure delivery of flexible and cost effective IT services which align with business priorities. A long term strategy should be through first of all looking across all potential IT services and determining the right balance of choice, flexibility, commercial tension and suppliers (internal and external).

Choosing which services to retain and which to outsource is key to delivery of business value and enabling a good multi-sourcing environment. Some suppliers are naturally more 'threatening' to others and therefore this can create an environment of non-cooperation, typically specialist or tier 2 suppliers are more accepting of multi-sourcing and have higher levels of cooperation with other suppliers in the IT services eco-system.

Finally, the original challenges that organisations face 10-20 years ago need to be addressed head on. Whilst on the surface in-sourcing aspects of service might appear to make sense and give greater control back to the customer; this approach is not right for every organisation and careful consideration needs to be made as to whether or not the customer could perform those services better in the long term than an IT supplier.

So, whilst it's unlikely that IT sourcing will go full circle, there is a growing trend for customers to take greater control and management of critical service components. Taking on board the lessons the industry has learned from 1st and 2nd Generation contracts it should be third time lucky... at least for now...

About the Authors

James Cockroft is a Director and one of the founders of Coeus Consulting. As Head of the Sourcing practice James has over 15 years experience in sourcing strategy, contract negotiations and execution.

james.cockroft@coeusconsulting.co.uk
+44 (0)7711 316 181

Catherine Randles is a Managing Consultant in the Strategy Practice, with over 20 years experience in developing IT operating models and global outsourcing programmes.

catherine.randles@coeusconsulting.co.uk
+44 (0)7747 020845

About Coeus

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Our consultants have the right blend of knowledge and experience to help our clients cut through complex technology issues.

Further Reading

A number of other articles, white papers and case studies are available from the Coeus Consulting website, including the popular Service Integration and Management (SIAM) white paper which studies the relative benefits of the different sourcing models for SIAM.



Coeus Consulting

Kemp House, 152 City Road,
London, EC1V 2NX

Tel: +44 (0)207 127 4321

Fax: +44 (0)207 127 4320

Email: info@coeusconsulting.co.uk

www.coeusconsulting.co.uk